United States Court of Appeals

for the Second Circuit

REPLY BRIEF

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To be argued by
GEORGE ROWE, JR.

75-4030

United States Court of Appeals
For the Second Circuit

Docket Number
75-4030

INTERNATIONAL FLAVORS & FRAGRANCES INC.,
Petitioner-Appellant,

against

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

ON APPEAL FROM THE UNITED STATES TAX COURT

REPLY BRIEF OF PETITIONER-APPELLANT

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Reply Brief of Petitioner-Appellant

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1. Preliminary Statement

This Reply Brief is submitted on behalf of Petitioner-Appellant ("IFF"), in reply to the brief of Respondent-Appellee ("the Commissioner").

This case concerns the proper tax treatment of a gain of $387,000 realized by IFF in the year 1967. On December 29, 1966, IFF entered into a contract with First National City Bank "FNCB") to sell to FNCB 1,100,000 pounds sterling at $2.7691 per pound, delivery of and payment for such pounds to be made on

January 3, 1968. The pound was devalued to $2.40 per pound in November, 1967, and the FNCB contract became valuable for that reason. On December 20, 1967, IFF entered into an agreement with Amsterdam Overseas Corporation ("Amsterdam") as follows:

> "Enclosed is the original of our agreement of December 29, 1966, with First National City Bank which we hereby sell to you today for $387,000. This sale is on the understanding that you will fulfill the obligation to deliver Sterling 1.1 million to First National City Bank on January 3, 1968, without recourse to us."

IFF claimed that the gain ($387,000) was long-term capital gain realized upon the sale of a capital asset held over six months and so treated it on its tax return for the year 1967.

Below, at trial, the Commissioner, in his opening statements and briefs, took the position that IFF's sale of the FNCB contract was equivalent to the fulfillment of the contract and that the case was governed by Section 1233 of the Internal Revenue Code, dealing with short sales of stocks, securities and commodity futures. That section, if applicable, would have called for a tax on IFF's gain as a short-term capital gain. Alternatively, the Commissioner took the position that IFF's contract with FNCB was a hedging transaction within the coverage of the Corn Products case, 350 U.S. 46 (1955). That case, if applicable, would have called for a tax on the gain as ordinary income. (Opening Statement, App. 25-31; Brief for Respondent, pp. 12-31; Reply Brief for Respondent, pp. 9-23, 25-44).

The Tax Court judges wrote three opinions. Judge Quealey wrote the opinion of the Court, with which three or more judges agreed. He held that IFF's contract with FNCB was a hedging transaction within the coverage of the Corn Products case and that IFF, accordingly, was subject to tax on the gain as ordinary income. Judge Tannenwald, in a concurring opinion with which two other judges agreed, disagreed with the majority, and said that the gain was subject to tax as a short-term gain, on the ground that Amsterdam had acted for IFF in fulfilling the contract. Judge Hall, with whom two other judges agreed, disagreed with the majority and the concurring opinion. She held that the gain was long-term capital gain, as IFF contended.

The Commissioner now on appeal disavows the majority opinion of the Tax Court, and otherwise abandons positions he took below. He now concedes that the Corn Products case is not applicable. (Brief, p. 13).* Moreover, he now also concedes that Section 1233 of the Code is not applicable. (Brief, p. 25 n.9). Those were the two main arguments he made below. See citations to the Commissioner's opening statement and briefs below, supra. He now rests his case solely on the argument suggested in part by Judge Tannenwald, that, in view of the circumstances surrounding the contract between IFF and Amsterdam, no sale of the IFF-FNCB contract should be deemed to have taken place,

*Unless otherwise noted, references to "Brief" are to the Commissioner's Brief on Appeal.

but that, rather, IFF should be deemed to have constituted Amsterdam as IFF's agent or broker (Brief, p. 18), or to have utilized Amsterdam as an intermediary (Brief, p. 17), or to have arranged to purchase or borrow Amsterdam's name (Brief, pp. 15, 17), or to have become a party to the Amsterdam-FNCB arrangements (Brief, p. 8) in order to fulfill the FNCB contract. Since Amsterdam purchased the pounds used to fulfill the contract within six months of January 3, 1968, the date they were delivered to FNCB, the Commissioner argues that IFF should be held to have realized a short-term capital gain at that time. (Brief, pp. 13, 16 n.6).

The principal circumstance upon which the Commissioner rests his argument is that on the day that Amsterdam purchased the IFF-FNCB contract, it also contracted with FNCB to purchase the pounds with which to fulfill the IFF-FNCB contract, and thus fixed its profit and eliminated its risk of loss on that contract. The Commissioner asks this Court to conclude from that fact alone, apparently as a matter of law, that IFF did not sell the contract to Amsterdam, that the transaction constituted an agency agreement or a name-lending or purchasing agreement or some other form of agreement in which IFF, as principal, is held to have been the one who bought the pounds and fulfilled the contract. (Brief, pp. 13-17). He argues that this Court should so conclude for the further reason that IFF had the burden of proving that Amsterdam had acted independently, a burden he says IFF did not meet. (Brief, pp. 18-27).

2. IFF's sale to Amsterdam should be respected as such, even though Amsterdam froze its profit and eliminated its risk of loss.

As stated, the Commissioner's argument is built upon the circumstance that on the day that Amsterdam purchased the IFF-FNCB contract, it also contracted to purchase the pounds with which to fulfill that contract. The Commissioner argues in Point B of his brief (p. 14) that no sale should be held to have taken place because "Amsterdam never acquired independent ownership of any significant property interest in the contract nor did it ever incur the attendant risk of loss or potential for gain which would have accompanied such ownership interests".

The Commissioner's argument is unsound as a matter of law. IFF and Amsterdam entered into a contract, pursuant to which Amsterdam purchased IFF's contract with FNCB for $387,000. Clearly, the nature or character of that contract is not altered by the fact that Amsterdam chose, in a separate transaction, to contract to buy pounds to fulfill the contract and thus fix its profit and eliminate its risk of loss. Seller and buyer were not thereby transformed into principal and agent. A hedge of the type in which Amsterdam engaged, in which an obligation in one contract is offset by a right in another contract, is a normal business practice,* and there is no warrant or authority in law

* See, e.g., R. Wixon, W. Kell & N. Bedford, Accountants' Handbook, 12-68, 69 (5th ed. 1970).

or in fact for saying that the latter transaction alters the legal nature or character of the first. As Judge Hall put it in the dissent below (App. 117-18):

> "After the devaluation the contract right to sell pounds for more than their value was a valuable and readily marketable asset. No shenanigans or special deals were required to sell it, and we have no evidence either occurred. While the purchaser, Amsterdam, froze its profits by simultaneously hedging, there is no reason this circumstance should convert petitioner's sale into something else. Petitioner clearly divested itself of all title to, and realistic further concern regarding, the contract, and became unconditionally entitled to the price. No more is required for a 'sale' which has the same meaning in tax law as in ordinary parlance."

The Commissioner seeks to recast the transaction in order to deprive IFF of the more favorable capital gains tax rates, but as the Tax Court itself stated in Ellis, Holyoke & Co., 29 T.C.M. 18, 32 (1970):

> "The fact that a transaction is arranged to favor some of the parties taxwise, affords ... no license to recast it into one of less advantage."

See also Meyer J. Stavisky, 34 T.C. 140 (1960), aff'd, 291 F.2d 48 (2d Cir. 1961) and other cases cited by us at pages 25 and 26 of our main brief.

The Commissioner asserts (Brief, p. 14):

> "The documents introduced ... in the Tax Court reveal that the series of transactions was

designed as a unitary plan composed of interdependent steps, no one of which was to be effected in the absence of the others." *

He asserts, further (p. 17), that IFF's contract with Amsterdam did not constitute a sale of the FNCB contract to Amsterdam but rather provided for a "fee" to Amsterdam for selling or lending its name to IFF for the purpose of fulfilling the FNCB contract. These assertions are not justifiable inferences from the record. They are simply conjectures and arbitrary characterizations by the Commissioner. The documents show no "plan" on IFF's part comprised of the steps which the Commissioner asserts. There is no basis in fact or in law to call Amsterdam's profit a "fee".

The authorities do not support the Commissioner's argument. In Commissioner v. Brown, 380 U.S. 563 (1965), taxpayers sought to sustain a sale of their stock in a lumber company to a tax-exempt institute. The taxpayers had claimed long-term capital gain on the sale. The agreement of sale provided that the institute was obliged to pay the purchase price

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* The Commissioner at page 14 of his brief implies that IFF produced and introduced the documents which comprised the Amsterdam-FNCB transaction, which is a distortion of the record. They were part of a joint stipulation of facts of the parties (App. 4-5), a procedure provided for in the Rules of the Tax Court. Mr. Morrison's testimony made it clear that those documents did not come from IFF. (App. 62).

only out of the profits of the lumber company. The Commissioner argued that the institute undertook no risk in the transaction and therefore no sale should have been deemed to have taken place for tax purposes. The Supreme Court held for the taxpayers, stating (at pp. 574-75):

> "Furthermore, risk shifting of the kind insisted on by the Commissioner has not heretofore been considered an essential ingredient of a sale for tax purposes .... The term 'sale' is used a great many times in the Internal Revenue Code and a wide variety of tax results hinge on the occurrence of a 'sale'. To accept the Commissioner's definition of sale would have ramifications which we were not prepared to visit upon taxpayers, absent Congressional guidance in this direction."

The Brown case has recently been followed in Berenson v. Commissioner, 507 F. 2d 262 (2d Cir. 1974).

The Commissioner's argument is patently inconsistent with S. C. Johnson & Son, Inc. v. Commissioner, 63 T.C. No. 74 (filed March 31, 1975). In that case, the Johnson Wax Company, an international company headquartered at Racine, Wisconsin, had in July 1967 entered into two contracts with two New York City banks for the sale to the banks of 1,500,000 pounds sterling, delivery and payment to be made in July 1968. Its reasons for entering into the contracts were similar to those of IFF in the instant case. Following the devaluation of the pound, the Wax Company assigned the contracts to a close affiliate, a charitable foundation, the Johnson Wax Fund, Inc., whose trustees

were officers and directors of the Wax Company. The Fund, upon the approval of the assignments by the banks, promptly sold the contracts to a New York City investment firm. It is clear from the opinion that, for all practical purposes, the assignments to the Fund and the sales by the Fund were completed contemporaneously. It is also clear that the Fund took no risk and that the Company and the Fund, being closely affiliated, each knew what the other was doing and intending to do throughout.

The Company claimed a charitable deduction in 1968 for the value of the contracts. The Commissioner argued inter alia that a transfer of the contracts had not really taken place, and that the Company should be held to have realized a profit on the disposition of the contracts. The Tax Court disagreed, held that a transfer had taken place, and refused to attribute to the Company the profit on the disposition of the contract.

The instant case is an even stronger case for taxpayer. Here there are two independent parties, no basis upon which to infer an agency and no reason to assume that one was a party to what the other was doing. A fortiori, IFF's sale of its contract in this case should be respected for tax purposes. See also Savoy Oil Co., 1 B.T.A. 230 (1924) (agreement which purports to be a sale will be so treated for tax purposes, absent clear and convincing proof that something else was intended).

The Commissioner seeks support from Frank C. LaGrange,

26 T.C. 191 (1956). We pointed out at page 32 of our main brief that that case was clearly distinguishable in fundamental respects from the instant case. In that case, the Court held that LaGrange, and not Loeb, Rhoades, LaGrange's broker, to whom LaGrange had purported tc sell his foreign exchange contracts, had closed the short sale, and had thereby realized a short-term capital gain rather than a long-term gain upon the sale of the contracts. The Court found that, in fact, Loeb, Rhoades was not acting as principal, but only as LaGrange's agent, resting its conclusion not only on the fact that the sale to Loeb, Rhoades was with full recourse to LaGrange in the event of loss upon the contracts, but also on the facts that Loeb, Rhoades did not stand to profit from the purchase, did not charge a commission on the transaction, and did not remit any funds to LaGrange until it had closed the contracts. None of such factors are present here.

If the Commissioner wanted in this proceeding to take the position which he takes now, namely, that Amsterdam acted as IFF's agent in fulfilling the contract in 1968, he would have been required to assert the deficiency for the year 1968, when the contract was fulfilled, and not for the year 1967, which is the year in which IFF sold the contract to Amsterdam. It is only IFF's return for the year 1967 which is before the Court in this proceeding. Naturally, IFF did not question the "timing" of the assessment, as the Commissioner points out in his brief (p. 16 n. 6). IFF obviously never considered that Amsterdam had acted

as its agent in closing out the transaction in 1968.

3. IFF met any reasonable burden of proof on it in this case.

As stated, the Commissioner argues in Point B of his brief that, because Amsterdam hedged and thus fixed its profit and eliminated its risk of loss, the sale by IFF to Amsterdam of the FNCB contract should be held, not a sale, but something else, with adverse tax consequences to IFF.

In Point C of his brief (p. 18), the Commissioner argues that this Court should hold that IFF had the **burden** of showing that Amsterdam acted independently in fulfilling the forward sales contract and that it failed to meet that burden. Judge Tannenwald made the same argument below in his concurring opinion. The argument is that, even though IFF established (1) that it had entered into a contract with Amsterdam calling for the sale of the FNCB contract to Amsterdam, (2) that Amsterdam was an independent company, fully capable of fulfilling the contract, (3) that there were no other contracts between the two companies and (4) that IFF was not a party to Amsterdam's transactions with FNCB, IFF had to come forward with yet more evidence to establish that its transaction with Amsterdam was exactly what it purported to be. The Commissioner does not explain what that evidence should be.

Clearly, IFF established a prima facie case. The

Commissioner presented no contrary proof. As stated in Karabagui v. The Shickshinny, 123 F. Supp. 99 (1954), aff'd, 227 F. 2d 348 (2d Cir. 1955):

> "Prima facie evidence is, of course, like all evidence, susceptible to rebuttal; but unrebutted, it remains sufficient as a matter of law to establish the ultimate proposition it purports to prove. It goes without saying that such evidence can only be overcome by contrary proof, and not by mere surmise and speculation."

The Commissioner points out that IFF did not call additional officers of IFF, or officers of Amsterdam or FNCB, to give oral testimony to further establish Amsterdam's independence and that the Court should draw inferences adverse to IFF on that account. The Commissioner conjectures that their testimony would show that IFF's officers "participated in or knew of" Amsterdam's transactions with FNCB. (Brief, pp. 19-20). However, evidence introduced at trial shows that IFF was not a party to or a participant in Amsterdam's contract with FNCB. Indeed, IFF showed at trial that it had not even received copies of the documents that comprised the Amsterdam-FNCB transaction. There was no testimony that officers of IFF knew or that they did not know of Amsterdam's transaction with FNCB, but, even if they did know, such a fact would hardly be material. This case does not turn upon whether an employee of IFF learned from an employee of Amsterdam or of FNCB that Amsterdam was purchasing or intending to purchase pounds to fulfill the contract and thus fix its profit and eliminate risk of loss.

If the Commissioner believed that such testimony would rebut IFF's case, that it would show that there were other agreements between the parties or some other fact or facts which would help him, it was up to the Commissioner to call such witnesses. They were equally available to him. His conjectures and surmises as to what their testimony might indicate are no substitute. As Judge Hall stated below (App. 118-19):

> "Petitioner's failure to prove its lack of knowledge of what Amsterdam planned to do with the contract is immaterial, for such knowledge could not add to or subtract from the finality of petitioner's disposition. The concurring opinion also refers to petitioner's failure to prove absence of 'participation' in the Amsterdam-City Bank arrangement, but the record is clear enough to support, indeed to require, the Court finding as a fact that the participants in that transaction were Amsterdam and First National City Bank. Moreover, petitioner could properly claim unfair surprise if taxed with the concurring opinion's theory that it failed to disprove that Amsterdam acted as petitioner's agent. Respondent's counsel, in his opening statement, admitted that 'IFF transferred its agreement with First National City Bank to Amsterdam Overseas Corporation for $387,000'. This admission, while in effect belatedly retracted by respondent's advancing a new theory at a second trial session, is quite inconsistent with any notion of IFF's subsequent retention of ownership. Accordingly, I would find that a sale took place, and the gain was long-term capital gain."

See Stout v. Commissioner, 273 F.2d 345, 350 (4th Cir. 1959) (presumption in Commissioner's favor disappears when taxpayer presents prima facie case); see also Bernuth v. Commissioner,

470 F. 2d 710, 714 (2d Cir. 1972); Herbert v. Commissioner, 377 F. 2d 65, 69 (9th Cir. 1966).

Conclusion

The decision below should be vacated and the case remanded to the Tax Court with instructions to enter a decision that there is no deficiency due from Petitioner-Appellant.

New York, New York
June 25, 1975

Respectfully submitted,

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IN THE UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

INTERNATIONAL FLAVORS & FRAGRANCES INC., Petitioner-Appellant,	:	
v.	:	No. 75-4030
COMMISSIONER OF INTERNAL REVENUE, Respondent-Appellee.	:	

CERTIFICATE OF SERVICE

I hereby certify that I have, on June 26, 1975, served copies of the Reply Brief of Petitioner-Appellant on Respondent-Appellee, by depositing two copies thereof in the United States mail, first-class postage prepaid, in an envelope addressed to its counsel at the following address

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Assistant Attorney General
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ATE OF NEW YORK, COUNTY OF ss.:

e undersigned, an attorney admitted to practice in the courts of New York State,

☐ Certification By Attorney certifies that the within has been compared by the undersigned with the original and found to be a true and complete copy.

☐ Attorney's Affirmation shows: deponent is the attorney(s) of record for in the within action; deponent has read the foregoing and knows the contents thereof; the same is true to deponent's own knowledge, except as to the matters therein stated to be alleged on information and belief, and that as to those matters deponent believes it to be true. This verification is made by deponent and not by

The grounds of deponent's belief as to all matters not stated upon deponent's knowledge are as follows:

e undersigned affirms that the foregoing statements are true, under the penalties of perjury.

ted:

.....
The name signed must be printed beneath

ATE OF NEW YORK, COUNTY OF ss.:

being duly sworn, deposes and says: deponent is

☐ Individual Verification the in the within action; deponent has read the foregoing and knows the contents thereof; the same is true to deponent's own knowledge, except as to the matters therein stated to be alleged on information and belief, and as to those matters deponent believes it to be true.

☐ Corporate Verification the of a corporation, in the within action; deponent has read the foregoing and knows the contents thereof; and the same is true to deponent's own knowledge, except as to the matters therein stated to be alleged upon information and belief, and as to those matters deponent believes it to be true. This verification is made by deponent because is a corporation and deponent is an officer thereof.

e grounds of deponent's belief as to all matters not stated upon deponent's knowledge are as follows:

.....
The name signed must be printed beneath

orn to before me on 19

ATE OF NEW YORK, COUNTY OF ss.:

being duly sworn, deposes and says: deponent is not a party to the action.

over 18 years of age and resides at

☐ Affidavit of Service By Mail On 19 deponent served the within upon attorney(s) for in this action, at the address designated by said attorney(s) for that purpose by depositing a true copy of same enclosed in a post-paid properly addressed wrapper, in — a post office — official depository under the exclusive care and custody of the United States Postal Service within the State of New York.

☐ Affidavit of Personal Service On 19 at deponent served the within upon the herein, by delivering a true copy thereof to h personally. Deponent knew the person so served to be the person mentioned and described in said papers as the therein.

.....
The name signed must be printed beneath

orn to before me on 19

NOTICE OF ENTRY

Sir:-Please take notice that the within is a *(certified)* true copy of a
duly entered in the office of the clerk of the within named court on 19

Dated,

Yours, etc.,

FULTON, WALTER & DUNCOMBE

Attorneys for

Office and Post Office Address

30 ROCKEFELLER PLAZA

Borough of Manhattan New York, N. Y. 10020

To

Attorney(s) for

NOTICE OF SETTLEMENT

Sir:—Please take notice that an order

of which the within is a true copy will be presented for settlement to the Hon.

one of the judges of the within named Court, at

on the day of 19

at M.

Dated,

Yours, etc.,

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To

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CERTIFICATE OF SERVICE OF REPLY BRIEF OF PETITIONER-APPELLANT

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To

Attorney(s) for

Service of a copy of the within

is hereby admitted.

Dated,

.....

Attorney(s) for